

10

Bankruptcy

This unit covers:

TOPICS

- Language of bankruptcy
- The WorldCom bankruptcy
- The bankruptcy process
- Crisis in corporate government
- Role of insolvency practitioners
- Debt management
- Alternatives to bankruptcy

SKILLS

- Reading: guessing meaning, predicting content, matching missing sentences
- Listening: listening for detail, listening to identify topics
- Speaking: talking about insolvency, bankruptcy presentations
- Writing: sequencing sentences in letters, word formation

READING

■ Section A Skills

TALKING POINT

Discuss these questions.

- 1 What are the advantages of going bankrupt?
- 2 What is a debt-management plan?

1 The language of bankruptcy

Match these words and expressions connected to bankruptcy (1–10) with their appropriate definitions (a–j).

- | | |
|--------------------------|--------------------------------------------------------------------------------------------------------------------------------------------|
| 1 voluntary liquidation | a the value of a company in a liquidation as an ongoing entity, which means the business continues, and a higher price is obtained |
| 2 apparent insolvency | b formal demand by a creditor giving a person 21 days to repay a debt. |
| 3 going concern | c the placing of a company into liquidation by resolution of its members |
| 4 winding up | d legal term that means someone is unable to pay their debts and that at least one of the creditors has taken legal action against him/her |
| 5 statement of affairs | e legal term for a formal application to the court for bankruptcy |
| 6 receiving order | f person who administers the bankruptcy (can be either the accountant in bankruptcy or a private insolvency practitioner) |
| 7 petition | g procedure whereby the assets of companies and partnerships are gathered in and liquidated |
| 8 statutory demand | h document completed by a bankrupt, company officer or director, which gives details of assets, debts and creditors |
| 9 trustee | i someone who has priority when funds are distributed by a liquidator, administrative receiver or trustee in bankruptcy |
| 10 preferential creditor | j court order in England or Wales placing assets under control of an Official Receiver |

'Failure is the opportunity to begin again, more intelligently.'
Henry Ford

The bankruptcy process

Article I, Section 8, of the United States Constitution authorizes Congress to enact “uniform laws on the subject of bankruptcies.”

(0) ~~H~~ The Bankruptcy Code, which is codified as title 11 of the United States Code, has been amended several times since its enactment. It is the uniform federal law that governs all bankruptcy cases.

The procedural aspects of the bankruptcy process are governed by the Federal Rules of Bankruptcy Procedure (often called the “Bankruptcy Rules”) and local rules of each bankruptcy court. The Bankruptcy Rules contain a set of official forms for use in bankruptcy cases. **(1)** _____

There is a bankruptcy court for each judicial district in the country. Each state has one or more districts. There are 90 bankruptcy districts across the country. The bankruptcy courts generally have their own clerk’s offices.

The court official with decision-making power over federal bankruptcy cases is the United States bankruptcy judge, a judicial officer of the United States district court. **(2)** _____ Much of the bankruptcy process is administrative, however, and is conducted away from the courthouse. In cases under Chapters 7, 12, or 13, and sometimes in Chapter 11 cases, this administrative process is carried out by a trustee who is appointed to oversee the case.

(3) _____ A typical Chapter 7 debtor will not appear in court and will not see the bankruptcy judge unless an objection is raised in the case. A Chapter 13 debtor may only have to appear before the bankruptcy judge at a plan confirmation hearing. Usually, the only formal proceeding at which a debtor must appear is the meeting of creditors, which is usually held at the offices of the U.S. trustee.

(4) _____ A fundamental goal of the federal bankruptcy laws enacted by Congress is to give debtors a financial “fresh start” from burdensome debts. The Supreme Court made this point about the purpose of the bankruptcy law in a 1934 decision: **(5)** _____

Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934). This goal is accomplished through the bankruptcy discharge, which releases debtors from personal liability from specific debts. **(6)** _____ This publication describes the bankruptcy discharge in a question-and-answer format, discussing the timing of the discharge, the scope of the discharge (what debts are discharged and what debts are not discharged), objections to discharge, and revocation of the discharge.

- A This meeting is informally called a “341 meeting” because section 341 of the Bankruptcy Code requires that the debtor attend this meeting so that creditors can question the debtor about debts and property.
- B “It gives to the honest but unfortunate debtor ... a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.”
- C At the same time, it prohibits creditors from ever taking any action against the debtor to collect those debts.
- D A debtor’s involvement with the bankruptcy judge is usually very limited.
- E The bankruptcy judge may decide any matter connected with a bankruptcy case, such as eligibility to file or whether a debtor should receive a discharge of debts.
- F The cases are traditionally given the names of the chapters that describe them.
- G The Bankruptcy Code and Bankruptcy Rules (and local rules) set forth the formal legal procedures for dealing with the debt problems of individuals and businesses.
- H Under this grant of authority, Congress enacted the “Bankruptcy Code” in 1978.

SPEAKING

■ Section A Skills

1 Talking about insolvency

Work in pairs.

Student A: Read Fact Sheet A on page 114 and prepare a presentation for your partner covering these points:

- what an individual voluntary arrangement (IVA) is
- how an IVA is arranged
- what happens in an IVA
- some of the advantages of an IVA

Student B: Read Fact Sheet B on page 115 and prepare a presentation for your partner covering these points:

- what a company voluntary arrangement (CVA) is
- how a CVA is drawn up
- how a CVA works
- some of the advantages of a CVA

TRIVIA

Rembrandt, the famous Dutch painter, went bankrupt in 1656.

2 Bankruptcy forum

Consider these questions addressed to an online bankruptcy forum and answer them with a partner.

1 My company has been experiencing problems, and we currently face insolvency. What can we do in this situation? Are there any alternatives to bankruptcy?

2 I need some advice. Can anybody tell me more about bankruptcy? I mean, how do I petition for my bankruptcy? Is this advisable?

3 I was declared bankrupt by the court last year. How long does bankruptcy last, and how can I be discharged from bankruptcy?

4 Can you tell me what the main changes of the new legislation (Enterprise Act 2002) are, and will this enable me to make a fresh start?

5 How can my bankruptcy be reversed, and in what circumstances?

6 What is 'discharge from bankruptcy', and how can I obtain it?

7 For the past 18 months we have been having serious financial difficulties, and I am considering applying for bankruptcy. If I do so, what will happen to my business in bankruptcy? Will I be able to continue trading?

8 Is it cheaper to make myself bankrupt. What are the costs involved?

9 What happens if a Bankruptcy Restrictions Order (BRO) is placed on me, and what are the restrictions?

10 My company was declared bankrupt last month. What effect will bankruptcy have on my personal credit rating?

■ Section B Exam focus

Three-minute presentations

Using the skeleton notes, create interactive three-minute presentations for these three headlines.

UK SURGE OF BUSINESS FAILURES AS CREDIT CRUNCH HITS COMPANIES

- Experian report – UK corporate insolvency: up 8.5% this quarter
- problem business sectors – agriculture, banking, food retail and clothing
- 10% of failures – building and construction
- East Midlands worst – insolvencies up 53.6%
- creditors' voluntary liquidations up 14.1%
- compulsory liquidations down 2.2%, perhaps reinforcing concerns about confidence as most debtors choose CVLs, not compulsory winding-up
- growth of corporate rescue – administrations and company voluntary arrangements – 23.7% and 37.6% respectively

INCREASE IN IVAs STRENGTHEN DEBT-MANAGEMENT COMPANIES

- increase in media coverage of debt problems – TV, Internet, newspapers
- record level of bankruptcies in UK – easy access to credit
- debt-management companies – high growth, i.e. Debts.co.uk – 79% jump in turnover
- individual voluntary arrangements – very popular solution – allow individuals % payment of debt over a period
- banks are calling for tighter regulation – losing money – many customers opt for IVAs – result – lower recovery for banks

PWC PREDICT MORE INSOLVENCIES AHEAD

- accountancy firm PricewaterhouseCoopers predict increase in UK bankruptcies
- PWC predictions – higher mortgages – more people rely on credit cards – debts will increase
- backlog of individual voluntary arrangements (IVAs) – push up insolvency figures
- UK insolvency figures and credit-card debt down slightly, but PWC report 'precious plastic', predicts change in trend
- over-borrowing by consumers – leading to more personal insolvencies

▶ See Language bank, Presentations, page 118

Unit 10, Speaking, Skills, Exercise 1

FACT SHEET A: INDIVIDUAL VOLUNTARY ARRANGEMENT

What is an IVA?

An individual voluntary arrangement (IVA) is a formal agreement between an individual and his/her creditors. The individual makes an arrangement with his/her creditors to make reduced payments towards the total amount of his/her debt in order to pay off a percentage of what he/she owes. Generally, after five years, the debt is classed as settled.

How does an IVA work?

Due to its formal nature, an IVA has to be set up by a licensed professional (an insolvency practitioner). Firstly, the individual is asked questions regarding his/her current financial situation. Based on this information, a repayment amount is agreed. Then the proposal for the IVA is drawn up by an insolvency practitioner. An application may then be made to the court for an Interim Order. Once this is in place, no creditors will be able to take legal action against the individual. A creditor meeting will be arranged, which the individual should attend. If the creditors agree to the IVA, it is approved.

The IVA is legally binding. As long the repayments are made, when the term of the agreement is finished, the individual will be free of the debts, regardless of how much has been paid off. During the period of the arrangement, the financial situation of the individual is regularly reviewed to see if there has been any change in his/her circumstances.

Some advantages of an IVA

1 Privacy

An IVA is a private agreement with creditors. This means that no one else needs to be told about it, so there is no negative publicity.

2 No professional disqualification

If an IVA is set up, the professional or employment status of the individual will not be affected; he/she can carry on running his/her own business and acting as a director. If someone is made bankrupt, he/she is not allowed to be involved in promoting, forming or managing a company without the permission of the court.

3 Costs

Setting up an IVA is less costly for the debtor and creditor than a bankruptcy procedure.

4 No loss of assets

With an IVA, the individual can keep his/her assets. If someone is made bankrupt, then all his/her assets are vested in the trustee, and they might have to be sold to repay the debts.

Other benefits of IVAs

- Up to 75% of the debt can be written off with an IVA.
- With an IVA, monthly repayments are based on what the individual can afford.
- When the IVA is completed according to the specified terms, the individual is considered to be debt-free.

Unit 10, Speaking, Skills, Exercise 1

FACT SHEET B: COMPANY VOLUNTARY ARRANGEMENT

What is a CVA?

A company voluntary arrangement (CVA) is an insolvency procedure that allows a financially troubled company to reach a binding agreement with its creditors about payment of all, or part, of its debts over an agreed period of time.

How is a CVA drawn up?

A CVA proposal is drafted by the directors with the assistance of a licensed insolvency practitioner, known as the 'nominee'. The proposals are then sent to the court, the creditors and the shareholders, giving them 14 days' notice of the CVA creditors' meeting.

How does a CVA work?

The nominee (an insolvency practitioner) reports to the court to arrange a meeting of creditors and shareholders to consider the proposal. The meeting decides whether to approve the CVA. If the meeting of creditors and shareholders approves a CVA, the nominee becomes the supervisor of the CVA. When the CVA has been carried out, the company's liability to its creditors is cleared.

Some advantages of a CVA

1 No interruption to business

The company can continue trading during the CVA and afterwards.

2 Cost effective

It provides a cost-effective way of avoiding outright insolvency for a company with financial problems.

3 Saves face

There is no stigma to a CVA compared to going into liquidation, so the reputation of the business is not affected.

4 Gives the company time

It assists businesses that have experienced trading difficulties since start up and need time to prove their business model.

5 Helps with short-term problems

It helps businesses which will be profitable in the long term, but which are under pressure from creditors.

6 Helps restructuring

It helps businesses that need some time to put together a new business plan or restructure the company.

7 No investigation

A CVA avoids the need for the licensed insolvency practitioner to investigate the affairs of the company.